

IRS News Release

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Remarks of Mark W. Everson Commissioner of Internal Revenue before the National Press Club Washington, D.C.

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WASHINGTON — Thank you very much. I am pleased to be here to speak about the importance of maintaining a balanced, fair system of tax administration. As you've just heard, I have been on the job for not quite a year so I am still going through my first filing season. It all peaks, of course, on April 15, one month from today. So far, so good, but it ain't over 'til it's over.

Going through the cycle for the first time, there are many new experiences, some of them personal. At the IRS our working equation is service plus enforcement equals compliance. Not service or enforcement; we have to do both. So this filing season, I felt it important that I provide personal service to at least one taxpayer. I chose our 16-year-old son, Leonard. Last summer and then again over Christmas, Leonard worked as a courtesy clerk at our local Safeway. He earned \$2,387, and we — the Government, that is — owe Leonard \$112, but he will get it only if he files his first tax return. Leonard needs to file a very simple form, the 1040 EZ.

Leonard's away at military school, but he will be home this Friday for a week-long break and I am ready for him. I've got a set of instructions for the form he needs to fill out. On the inside front cover, I've altered ever so slightly the Message from the Commissioner. Instead of "Dear Taxpayer" it's now "Dear Leonard." And I've crossed out the "Sincerely, Mark W. Everson" closing and replaced it with "Love, Dad." So he's good to go. That's the service side. But if Leonard needs anything in the way of enforcement — let's say he adds three zeros to his refund claim - I will turn him over straightaway to our criminal investigation division. Just kidding, mom!

One of the strongest features of our democracy is the generation of tax revenues through a system of individual self-assessment. As President Kennedy wrote in a special message to Congress over forty years ago, "The integrity of such a system depends upon the continued willingness of the people honestly and accurately to discharge this annual price of citizenship." These words remain as true today as when they were written in 1961.

Clearly, if the IRS provides appropriate service to taxpayers, they will be more willing to pay what they should. By service, we mean helping people understand their tax obligation and making it easier for them to participate in the tax system. Adam Smith, the Scottish economic philosopher, believed that the "tax which each individual is bound

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to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought to be clear and plain to the contributor, and to every other person.”

It wasn't so long ago that IRS service was not all that it should be — some would even say it was poor. In many areas the service level we provided, or more accurately stated, failed to provide, frustrated taxpayers and no doubt reduced their willingness to pay. While some of the allegations directed against the IRS in the mid-nineties were subsequently proven to be unfounded or overblown, there was, nevertheless, at its core a significant gap between the services the IRS was providing taxpayers and those which the public had a right to expect. This shortfall in services clearly warranted the fundamental improvements and reorganization established under the Internal Revenue Service Restructuring and Reform Act of 1998.

The reorganization of the IRS along customer lines of business and the other changes brought about by RRA 98 were, taken as a whole, sound reforms. The twin themes of the legislation were improvement of service and protection of taxpayer rights.

Through an almost single minded focus on RRA 98 implementation, the IRS has demonstrated unmistakable progress in improving customer service and increasing its recognition of and respect for taxpayer rights. While the ultimate desired level of customer service remains to be reached, the IRS's improvement and commitment with respect to these core goals is incontrovertible, established and measurable.

The reorganization of the IRS around customer groupings has provided a greater focus on service and increased accountability to the public. And produced real results. Last year 53 million individuals filed their returns electronically. Thus far this year, almost half way into the filing season, electronic filing is up again, by about 10 percent. Electronic filing is more reliable, both for the taxpayer and the Service. And it's faster. Over three-quarters of Americans get refunds, and we issue the refund in about half the time when a taxpayer files electronically.

One of the real problems in the '90's was getting through to the IRS at all. We now have a world-class call routing system, akin to those used by the airlines. A call is directed to the right person, someone who knows something about charitable contributions or IRA's — whatever the subject may be — and the system balances workforce planning against predictable workload patterns to reduce waiting time. Busy signals — the crudest indication of service failure — decreased from 400 million in 1995 to 600 thousand in 2003.

Are we where we need to be? Not yet. As many of you know, I've been emphasizing enforcement, to which I'll turn in a minute, but I don't want anyone to think the IRS will walk away from service. We still continue to maintain and improve service.

Our objectives for improved taxpayer service are three-fold:

- First, to improve and increase service options for the tax paying public,

- Second, to facilitate participation in the tax system by all sectors of the public, and
- Third, to simplify the tax process.

These are service objectives that recognize the dynamics of a rapidly changing world. One in which the Internet will be the dominant communications tool, but there will remain a wide range of computer and technological literacy among individual taxpayers. An America with an increasingly diverse population, including significant numbers of recent arrivals to our country from nations with cultures having a less developed respect for the rule of the law and the payment of taxes.

As this group would appreciate, continued changes in traditional media will make it harder to cover the waterfront as we seek to educate taxpayers. And, if history is any lesson, and here I want to be a realist, the tax laws will continue to grow more complex. Complexity, along with the frequency of changes in the tax law, is not only a challenge to taxpayers trying to comply with the tax laws, but a basis of cynicism about complying with the tax laws.

All of these environmental factors will provide significant service challenges to the IRS, in a world increasingly impatient for prompt and reliable information and transaction processing. A good example of the challenges we will face is reconciling our desire to standardize our processes through electronic filing with the reality that some groups, such as immigrants and the elderly, will need different, targeted services. Electronic filing is important to the IRS and to taxpayers, but we cannot overemphasize it to the detriment of services to taxpayer groups who will not utilize it. Addressing competing priorities on the service side of the IRS will not be easy, but we will work diligently to provide a balanced, effective program.

When President Kennedy tellingly described our system of individual tax assessment as the “annual price of citizenship,” he went on to say:

“To the extent that some people are dishonest or careless in their dealings with the government, the majority is forced to carry a heavier tax burden. For voluntary self-assessment to be both meaningful and productive of revenues, the citizens must not only have confidence in the fairness of the tax laws, but also in their uniform and vigorous enforcement of these laws. If non-compliance by the few continues unchecked, the confidence of the many in our self-assessment system will be shaken and one of the cornerstones of our government weakened.”

Unfortunately, the strong mandate of RRA 98 to improve IRS services to the taxpaying public made it difficult to balance both the service and enforcement elements that President Kennedy so eloquently identified as necessary to the success of our system. While I’m not sure, given the realities and political imperatives of the time, that there was much of a choice, most would agree that improvement of IRS taxpayer services was achieved in large part at the expense of needed enforcement activities.

Over a five-year period beginning in 1997, the IRS drew down its enforcement resources significantly. The number of revenue agents — those who conduct audits; revenue officers - those who collect monies due; and criminal investigators — those who prepare cases for possible prosecution by the Justice Department — each declined by over a quarter. Of course, this diminution of resources, together with a considerable reticence to enforce the law arising from RRA '98, took its toll. Audit rates declined, as did criminal prosecutions and enforcement revenues accruing to the government.

In essence, we decided to ignore the admonition of President Kennedy and his IRS Commissioner Mortimer Caplin, who I am pleased, is here with us today, that “Large continued avoidance of tax on the part of some has a steadily demoralizing effect on the compliance of others.” And we could not have turned away from our responsibility to combat avoidance and evasion at a worse moment: just when corporate governance was coming off the tracks; when the accounting and legal professions were tolerating an unprecedented and sad decline in professional ethics on the part of too many of their most respected players; a time when what many have termed a culture of greed was clouding judgment and allowing large numbers of taxpayers to believe that they really need not pay their fair share.

We are correcting our course and re-centering the agency. We are strengthening IRS enforcement of the tax laws in a balanced, responsible fashion. And we will do so without compromising taxpayer rights. As the IRS enhances enforcement, we have four priorities:

First, we are working to discourage and deter non-compliance, with emphasis on corrosive activity by corporations, high-income individuals and other contributors to the tax gap. Attacking abusive tax shelters is the centerpiece of this effort. What is at stake is greater than many billions of dollars of lost tax revenues. Our surveys indicate that 80 percent of Americans believe it is very important for the IRS to enforce the law as applied to corporations and high-income individuals. Enforcing compliance in these sectors is critical to maintaining Americans' faith that our system is fair. The abuses of recent years have to a very real degree strained the credibility of our tax administration system.

The IRS is moving aggressively to attack these transactions. Working with our partners in the Treasury Department, we have accelerated the issuance of guidance identifying abusive and potentially abusive transactions and improved disclosure requirements to provide greater transparency -- sorely needed in today's complex world. And we have over 100 promoter audits underway, not to mention thousands of audits of high-income individuals and corporations who have entered into potentially abusive transactions. Where necessary, the Treasury Department, on behalf of the Administration, has proposed legislation that would prohibit abusive transactions where audits alone may not be successful.

But we need to do better. We need to do more, and we particularly need to do it faster. The length of time it takes us to complete the audit of a large, complex corporation is five years from the date the return is filed, which in most cases is already eight and one-half months after year end. And these figures don't include the appeals process, which

runs another two years before the matter is settled or goes to court. That means that half of our current inventory of large cases is from the mid-nineties or the early nineties. In today's rapidly changing world, we might as well be looking at transactions from the Civil War. Simply stated, the IRS did not detect and deter the abusive transactions of the late nineties on an adequate or timely basis because we didn't have an informed view of current taxpayer behavior, only an historical understanding of events long past. And the challenge is becoming greater every day, as promoters of abusive tax transactions operate globally, without regard to national boundaries.

This makes it imperative to get current in our audits, to identify transactions and shorten the feedback loop so that potentially abusive shelters can be shut down promptly. I am convinced we can do it. Technology will help. Right now it takes two years on average before complicated corporate returns find their way into the hands of the assigned examiner. We are addressing this issue. Electronic filing by corporations will facilitate our analysis of data and help us calibrate risk. Through speedier audits we will provide better service to the compliant taxpayer by resolving ambiguity earlier, and hold accountable those who seek to game the system. And we are creating a web of disclosure, registration and maintenance of investor lists that will provide information about abusive transactions.

Our second priority is to assure that attorneys, accountants and other tax practitioners adhere to professional standards and follow the law. When I started work at Arthur Andersen in New York as a young auditor, the year was 1976. I was not yet twenty-two years old. All of us — in fact I would dare say anyone at a big eight accounting firm or leading law firm of the time — were given an unmistakable understanding of professional expectations and standards: your first responsibility was to make sure your client followed the law and observed appropriate standards. Then, if you could, you attempted to differentiate the firm based on service.

Over the last three decades, with an accelerated slide in the nineties, the model for accountants and attorneys changed. The focus shifted from independent audit and tax functions, premised on keeping the client out of trouble, to value creation and risk management. The tax shelter industry had a corrupting influence. It got so bad that in some instances blue chip professionals actually treated compliance with the law — in this case IRS registration and list maintenance requirements — as a business decision. They weighed potential fees for promoting shelters but not following the law against the risk of IRS detection and the size of our penalties.

Our system of tax administration depends upon the integrity of practitioners. The vast majority of practitioners are honest and scrupulous, but even they suffered from the erosion of ethics by being subjected to untoward competitive pressures. The IRS is acting. We have augmented our Office of Professional Responsibility by doubling its size and appointing as its director a tough, no nonsense, former prosecutor; we are tightening the regulatory scheme; and we are receiving excellent support from the Justice Department in our promoter and associated investigations. But we need the Congress to enact tougher penalties for those promoters who haven't yet gotten the message.

Our third enforcement objective is to detect and deter domestic and offshore-based criminal tax activity, our traditional area of emphasis, and financial criminal activity. Our Criminal Investigation Division is a storied and proud law enforcement agency. Their expertise comprises not just criminal tax matters but other financial crimes. Our investigators are the best in law enforcement at tracking and documenting the flow of funds. In addition to our tax investigations, the IRS has over one hundred agents assigned on an ongoing basis to support the President's Corporate Fraud Task Force. We will continue and intensify these important efforts.

Two factors account in significant part for America's great economic vigor and success. They are our pervasive culture of entrepreneurship, on the one hand, and the stability and transparency of our markets on the other. The reputation and attractiveness of our markets have been compromised by the scandals of recent years, including the peddling and use of abusive tax shelters. The President's Corporate Fraud Task Force and the Congress with Sarbanes-Oxley have taken important steps to restore confidence. Through these three enforcement initiatives, the IRS will do its part to make sure tax administration contributes to and does not detract from our economic system.

We have one more enforcement priority. The stakes for America in this area are also important. We will discourage and deter non-compliance within tax exempt and government entities, and the misuse of such entities by third parties for tax avoidance or other unintended purposes. Non-compliance involving tax-exempt entities is especially disturbing because it involves organizations that are supposed to be carrying out some special or beneficial public purpose. A case in point is credit-counseling agencies. A troubling number of these organizations, which have been granted tax-exempt status because they are supposed to be educating and assisting people who are experiencing credit or cash flow problems, are instead operating for the benefit of insiders or in league with profit-making loan or other companies to generate income from lending to these distressed individuals and families. We are taking a close look at these organizations to ensure that they are operating within the bounds of the law. If we don't act to guarantee the integrity of our charities, there is a risk that Americans will lose faith in and reduce their support more broadly for charitable organizations, damaging a unique and vital part of our nation's social fabric.

It is of course imperative as we reinvigorate the enforcement program that IRS employees maintain their respect for and diligence to all taxpayer due process rights and protections.

We confront significant challenges today. We face a large annual tax gap — the difference between what our taxpayers are supposed to pay when their tax obligations become due and what is actually collected. Moreover, in the last four years, the proportion of Americans who say it is OK to cheat on paying your taxes rose from 11 percent to 17 percent — a trajectory which, if not reversed, will threaten the government's future revenue stream and basic respect for the rule of law.

Our enforcement statistics for Fiscal 2003, released last week, demonstrate that we have arrested the enforcement decline which began in the nineties and worsened with the implementation of RRA 98. Audits, criminal investigations and monies collected

were all up. The President has asked for a 5 percent budget increase for the IRS for Fiscal 2005 — ten times the average increment for non-Homeland, non-Defense agencies. This strong commitment to tax administration will provide a 10 percent augmentation to our enforcement resources. I am hopeful that Congress, where there are increasing signs of bipartisan support for the President's request, will provide the needed funding.

We at the IRS will do our share. We've lagged, for reasons that are understandable, in tax enforcement. We had an environment in recent years where our personnel, in some instances, were hesitant to enforce the tax laws. But that is changing. We will continue to improve service and respect taxpayer rights. But we will also enforce the law. We won't relax until taxpayers who are unwilling to pay their fair share see that that is not a worthwhile course to follow. To return to President Kennedy's words about taxes, the great majority of Americans does honestly and accurately "discharge this annual price of citizenship." Average Americans deserve to feel confident that, when they pay their taxes, their neighbors and competitors are doing the same.

On a closing note, I would like to add that the IRS is not the only national tax agency facing the challenges I have outlined. I am pleased to tell you that the tax authorities of Australia, Canada, the United Kingdom and the United States have begun discussions to form a joint international task force to increase collaboration and share information about abusive tax transactions that are operating in and out of our four countries. I expect that our joint effort will enable the four countries to: share expertise, best practices and experiences in order to identify and better understand abusive tax transactions and those who promote them; to exchange information about specific abusive tax transactions and their promoters and investors within the framework of our countries' existing bilateral tax conventions; and to carry out our individual abusive tax transaction enforcement activities more effectively and efficiently.

This is an unprecedented step in the battle against the plague of abusive tax transactions.

Thank you.